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No. 80-666

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

In the Matter of the New York, New Haven and Hartford Railroad Company,

Debtor,

THOMAS B. BARRY,

Petitioner,

v.

AMERICAN FINANCIAL ENTERPRISES, INC.,

Respondent.

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Did the Court of Appeals err, as a matter of law, in unanimously affirming, as not an abuse of discretion, the District Court's approval of a compromise plan of reorganization on the ground that it "strikes a fair and equitable balance among the competing claims" because "the terms of the proposed compromise fall within the reasonable range of litigation possibilities"?

2. Should this Court grant *certiorari* to review the decision of the Court of Appeals which applied to the particular compromise in this case, the long-established and universally accepted standard for determining whether a compromise settlement of a railroad reorganization should be approved?

COUNTERSTATEMENT OF THE CASE

More than 19 years after the New York, New Haven and Hartford Railroad Co. (the "New Haven") initially filed a voluntary petition for reorganization under Section 77 of the Bankruptcy Act (the "Act"), 11 U.S.C. § 205, and with no end of litigation in sight, all of the competing creditor interests negotiated a compromise plan of reorganization which enabled the New Haven reorganization—one of the longest in modern railroad history—finally to be terminated. The United States District Court for the District of Connecticut (the "Reorganization Court") determined, as required by the Act, that the compromise plan was "fair and equitable" and approved it, and the United States Court of Appeals for the Second Circuit unanimously affirmed.

Although the Petition for Certiorari asks this Court to review one of the many legal issues compromised by the parties, the only issue before the Court of Appeals, and hence the only issue which could be before this Court if *certiorari* were granted, is whether the Court of Appeals properly applied the appropriate standard in approving the compromise settlement. Since Petitioner, whose holdings represent less than 0.04% of the total creditor interests, declined to apply for a stay of consummation after the Court of Appeals decision, the Reorganization Court consummated the compromise plan,[1] distributed the New Haven's assets to Respondent, the successor company,[2] and discharged the Reorganization Trustee.

By April, 1978, the New Haven reorganization had proceeded to the point where the estate had sold its railroad assets to the Penn Central Transportation Co. ("Penn Central") and

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1 The Act required that the compromise plan be submitted to the affected bondholders for their approval before it could be consummated. It was approved by 99.95% of the First Mortgage Bondholders and 92.83% of the Income Bondholders who validly voted. (A 115.)

2 A majority interest in Respondent, American Financial Enterprises, Inc., is held by American Financial Corp., which company is traded on the over-the-counter securities market. (This statement is made in fulfillment of Rule 28.1 of the Rules of this Court.)

consisted solely of cash and publicly traded Penn Central securities. There remained the adjudication of the various claims to the assets of the estate. In view of the limited assets available, the realistic controversy was between the two secured systemwide classes of creditors—the senior First Mortgage Bondholders and the junior Income Bondholders.

Although the Reorganization Court had repeatedly urged these two creditor interests to resolve their differences through settlement, they had been unable to do so. Accordingly, on April 18, 1978, the Trustee filed his proposed Plan of Reorganization, the essence of which was that all creditors senior to the two secured bondholder classes would be paid in cash, a successor corporation would receive the remaining assets of the New Haven, the First Mortgage Bondholders would receive approximately 93% of the equity of the successor corporation and the Income Bondholders approximately 7%, and interests junior to these two bondholder classes would receive nothing.

The Reorganization Court held exhaustive hearings on the proposed plan which covered 46 trial days over a nine-month period, and over 800 pages of briefs were filed by the parties. Since the First Mortgage Bonds were undisputedly senior to the Income Bonds, the First Mortgage Bondholders urged positions on a variety of contested legal and factual issues which would reduce the size of the estate and increase the amount of the First Morgage Bond claims so that there would be no assets left after satisfying those claims and the Income Bondholders would receive no equity in the reorganized company. The Income Bondholders took opposite positions, arguing that there were extensive assets left over after satisfaction of the First Mortgage Bond claims to which the Income Bondholders were entitled and hence they should receive substantial equity in the reorganized company.

The most important issue was the valuation of the estate. The First Mortgage Bondholders urged that the estate's principal asset—the Penn Central securities—be valued at their actual market value, which would result in a valuation of the entire estate substantially less than the undisputed amount of the First Mortgage claims, thereby leaving nothing for the

Income Bondholders. The latter argued for a valuation based on "intrinsic value," which they urged was high enough to satisfy all of the First Mortgage claims and leave substantial equity for them. Another hotly contested issue was the value to be given to the New Haven's "tax attributes"—the tax savings that would result when the extensive losses incurred by the New Haven over many years were used to offset future profits made by the reorganized company. Again consistent with their economic interests, the First Mortgage Bondholders urged a low valuation for these tax attributes so as to reduce the overall value of the estate, and the Income Bondholders urged a high valuation. A third litigated issue was whether the First Mortgage Bondholders' claim should include interest for the period subsequent to the filing of the original bankruptcy petition in 1961.

On February 14, 1980, the Reorganization Court rendered a 75-page opinion (the "February 14 Opinion") which the Court of Appeals characterized as "a painstaking and careful weighing of the arguments presented by all of the parties." (A 113.) That opinion accepted the basic structure of the Trustee's proposed plan, but significantly modified it in response to the evidence and arguments submitted by the parties. The Court accepted the position of the Income Bondholders that the Penn Central securities in the estate should be given an "intrinsic value" substantially higher than the value at which they were trading in the public securities markets. It is not disputed that if the Reorganization Court had adopted market value, as urged by the First Mortgage Bondholders, or if the Court of Appeals had adopted this position on appeal, the junior Income Bondholders would have received no equity in the reorganized company. By accepting intrinsic value, and adjusting other elements in the Trustee's proposed plan, the February 14 Opinion assigned the First Mortgage Bondholders approximately 93.9% and the Income Bondholders approximately 6.1% of the reorganized company.

All of the competing interests announced their intention to move for reargument and rehearing before the Reorganization

Court and to appeal if necessary. Faced with interminable further litigation, the parties reinstituted settlement negotiations. This time they were successful and all of the creditor interests who had participated in the reorganization proceeding agreed upon a compromise plan of settlement which generally followed the terms of the plan approved by the Reorganization Court, except that it gave a larger interest in the reorganized company to the Income Bondholders (7%) and correspondingly less to the First Mortgage Bondholders (93%). After an additional hearing on the compromise plan, the Reorganization Court approved it as "fair and equitable" by Order dated April 10, 1980. Since the Reorganization Court had rendered a comprehensive opinion only two months before which set forth its views on every aspect of the reorganization plan and every litigated issue, and since the compromise plan was substantially similar to the Reorganization Court's, the Reorganization Court promptly concluded that it was fair and equitable.

The only final order ever entered by the Reorganization Court approving a plan of reorganization was the one dated April 10, 1980. In that Order the Reorganization Court expressly recognized that it was approving a "compromise" plan. (A 97.) It is from this Order that Petitioner appealed. As the Court of Appeals stated:

> "This is an appeal from an order entered by District Judge Robert C. Zampano of the District Court of Connecticut on April 10, 1980, approving a consensual plan of reorganization." (A 107.)

The Reorganization Court never entered an order carrying out its February 14 Opinion because the compromise plan was agreed upon before reargument. Since the only order which was entered adopting any plan, the only one which could have been appealed, and the only one which in fact was appealed, was the April 10, 1980 Order approving the compromise plan, the only issue before the Court of Appeals was whether the Reorganization Court had abused its discretion in approving the plan. The Court of Appeals specifically recognized that

Petitioner's attempt to isolate one of the many issues which had previously been argued to the Reorganization Court and which had been compromised by the parties—whether interest should run after 1961—was misplaced, and the only issue before it was whether the compromise plan was properly approved. (A 116.) The Court of Appeals applied the universally accepted standard for determining whether a Court should approve a plan compromising a railroad reorganization—whether it is fair and equitable—and determined that the Reorganization Court was fully justified in concluding that this particular compromise plan met that test.

REASONS FOR DENYING THE WRIT

I.

THE ONLY ISSUE ON APPEAL IS WHETHER THE COMPROMISE PLAN IS FAIR AND EQUITABLE; NOT WHETHER POST-PETITION INTEREST SHOULD BE ALLOWED

The only reason advanced by Petitioner why this Court should grant *certiorari* is to resolve the legal issue whether post-petition interest should be allowed to secured creditors in a railroad reorganization. But this issue was not decided by the Court of Appeals and is not before this Court.[3]

As shown in the Counterstatement of the Case, *supra*, while it is true that the issue of post-petition interest was argued to the Reorganization Court during the hearings on the Trustee's proposed plan and adjudicated in the February 14 Opinion, that Opinion is simply not the subject of this appeal. It was superseded by the subsequent compromise plan which compromised the post-petition interest issue along with many others

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3 Even if it were, it is hardly significant or important enough to warrant this Court's attention. Furthermore, the resolution of this issue in the Reorganization Court's February 14 Opinion (A 90-1) is clearly correct and not in conflict with any decisions in other circuits. *See, e.g.*, In re Penn Central Transportation Co., 596 F.2d 1102, 1121 (3d Cir. 1979).

and was approved by the Reorganization Court as fair and equitable in its April 10, 1980 Order.

As the Court of Appeals explicitly recognized, the April 10 Order is the only one on appeal, and the only issue on appeal is whether the Reorganization Court abused its discretion in approving the compromise plan in entering that Order. (A 114, 123.) The Reorganization Court and the Court of Appeals were never called upon and never did decide the post-petition interest issue in determining that the compromise plan was fair and equitable. They decided only that the overall settlement was within the range of litigation possibilities considering all the issues that affected the ultimate outcome, and particularly the overriding issue whether the estate's assets should be given a market or intrinsic value.

II.

THE COURT OF APPEALS PROPERLY APPLIED THE WELL-ESTABLISHED STANDARD IN APPROVING THE COMPROMISE PLAN; ITS DECISION PRESENTS NO CONFLICT WITH OTHER CIRCUITS

Since the Petition focuses exclusively on the nonissue of post-petition interest, it does not contend that there is any reason for this Court to review the actual issue on appeal—whether the compromise plan was properly approved. It is beyond dispute that the Court of Appeals properly applied a standard that has been long established and universally accepted by this Court and the Courts of Appeals in approving railroad reorganization settlements.

Section 27 of the Act empowered the reorganization trustee, with the court's approval, to negotiate a compromise reorganization plan, and this Court has acknowledged that "[c]ompromises are 'a normal part of the process of reorganization.' " *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414, 424 (1968), quoting *Case v. Los Angeles Lumber Products Co.,* 308 U.S. 106, 130 (1939).

Reorganization courts, of course, are charged with scrutinizing compromises to insure that they meet the standard of being fair and equitable. In *TMT* this Court explained:

> "[T]he requirements . . . that plans of reorganization be both 'fair and equitable' apply to compromises just as to other aspects of reorganizations. . . ." 390 U.S. at 424.

The judicial test for determining whether a compromise plan meets the standard of "fair and equitable," is equally well established. The Court of Appeals, quoting from the recent opinion of the Third Circuit in approving a compromise settlement of the Penn Central reorganization, phrased the test as follows: "[W]hether or not the terms of the proposed compromise fall within the reasonable range of litigation possibilities" (A 116), quoting from *In re Penn Central Transportation Co.*, 596 F.2d 1102, 1114 (3d Cir. 1979). This standard was established by this Court in *TMT, supra* at 424-25. It has been followed in other Circuits as well: *Florida Trailer & Equipment Co. v. Deal,* 284 F.2d 567, 571, 573 (5th Cir. 1960); *In re California Associated Products Co.*, 183 F.2d 946, 949-50 (9th Cir. 1950); *In re Equity Funding Corp.*, 416 F. Supp. 132, 145 (C.D. Cal. 1975). In *Penn Central,* the Third Circuit reasoned that a compromise plan would fall within this range if it affords better treatment than if a party had lost the litigation which was settled, and worse treatment than if it had won. *Penn Central, supra* at 1120-21.

The Court of Appeals' application of this established test to the compromise in this case was eminently correct. Petitioner is a holder of Income Bonds which received 7% of the equity in the reorganized company under the compromise plan even though they were admittedly junior to the First Mortgage Bonds. If the Income Bondholder representatives had continued to litigate instead of compromising, they very likely would have ended up with no interest at all, and thus the compromise affords them better treatment than if they had litigated and lost. Although the Income Bondholders could have lost on any number of issues, the one used as an example by the Court of Appeals (A 119-22) fully demonstrates the point.

Even if the Reorganization Court had accepted the Income Bondholders' argument on post-petition interest, it is uncontested that the First Mortgage Bondholder senior claim would amount to at least $101,000,000. Thus if the total New Haven estate were valued at less than $101,000,000, all of the estate would be used to satisfy the First Mortgage claims and the Income Bondholders would receive nothing. All of the Penn Central securities held by the estate are publicly traded on the open market. It is undisputed that at the time of the February 14 Opinion the total value of these securities, based on market prices, plus the cash which was the only other asset of the estate, aggregated only approximately $80,000,000. (A 73, 123.) It is a simple matter of mathematics that the Income Bondholders would have received nothing, even if their post-petition interest argument were ultimately vindicated, if the valuation of the estate were based on market value, as the First Mortgage Bondholders contended, and not on "intrinsic value" as the Income Bondholders contended and the Reorganization Court found in its February 14 Opinion.

While not having to decide this issue because it was compromised by the parties, the Court of Appeals strongly indicated that it would have reversed the Reorganization Court and adopted the market value approach:

> "[U]se of market value which was the approach urged by the Mortgage Bondholders, is a straightforward and usually reliable method of ascertaining the worth of securities. We have recently held that 'in a free and actively traded market absent compelling reasons to believe otherwise, the market price [of stock] is held to take account of asset value as well as the other economic, political, and financial factors that determine "value". *Seaboard World Airlines Inc. v. Tiger International Inc.*, 600 F.2d 355, 361-62 (2d Cir. 1979). In *E.I. DuPont de Nemours Co. v. Collins,* 432 U.S. 46 (1977), the Supreme Court sustained the SEC's method of valuing a closed-end investment company by the market price of the underlying securities which it owned. Other courts have also accepted the market value as the preferred method of valuing

> securities. See *Mills v. Electric Auto-Lite Co.*, 552 F.2d 1239, 1247 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977); *Amerada Hess Corp. v. Commissioner*, 517 F.2d 75, 84 (3d Cir.), *cert. denied*, 423 U.S. 1037 (1975); *Central States Electric Corp. v. Austria*, 183 F.2d 879, 884 (4th Cir. 1950), *cert. denied*, 340 U.S. 917 (1951); *In re Equity Funding Corp. of America*, 416 F. Supp. 132, 144 (C.D. Cal. 1975).
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> ". . . [T]he stigma of bankruptcy surely lessens as time goes by; the Penn Central securities have now been actively traded for almost two years and the price has remained fairly stable. And it is not unreasonable to assume that today's sophisticated investor is capable of analyzing with some success the future prospects of the Penn Central." (A 121-22.)

It is hard to conceive of a more dramatic vindication of the Petitioner's representatives in negotiating the compromise than this strong indication that the Income Bondholders would have come away empty-handed had they continued the litigation. The compromise plan which gives the Income Bondholders 7% of the equity in the reorganized company was therefore well within the range of litigation possibilities.

Petitioner has not pointed to any decision by any other Court of Appeals which is in any way in conflict with the Second Circuit's decision below on this controlling issue, and there is none.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that this Court should deny the petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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